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Current Support Brief

THE CAPITAL USE CHARGE IN HUNGARY

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THE CAPITAL USE CHARGE IN HUNGARY

On 1 January 1964, Hungary instituted a capital use charge, amounting to about 5 percent per year, on the gross value of both fixed and working capital of industrial enterprises operating under ministerial direction. This levy is similar to an interest charge, a capitalist device that had been ideologically unacceptable in the Soviet Bloc until now. At present, however, several countries of the Bloc, impelled by current economic difficulties to consider even unorthodox measures, are considering the merits of a capital charge as an incentive to increased economic efficiency. East Germany has announced that it intends to introduce a capital use charge on a limited, experimental scale in 1964. Some Soviet, Polish, and Bulgarian economists have discussed the possible usefulness of such a charge in their countries. Czechoslovakia, whose severe current economic difficulties have made it exceptionally receptive to economic innovations, may be expected to give the Hungarian experiment particular attention.

Until the next general revision of producers' prices, which will take account of the capital use charge as a component of cost, Hungarian enterprises will pay the charge from profits. The share of profits that enterprises must turn over to the state budget is to be reduced in most cases, but not by as much as the amount of the capital use charge. Consequently, enterprises will be under greater pressure to reduce their costs.

1. Expectations

The Hungarians hope that the new charge will be an incentive to more efficient use of enterprise assets. Even before the next price revision, the new measure is expected to encourage industrial managers to use fixed capital more intensively -- and perhaps to maintain it better -- and to discourage them from holding excess stocks of equipment, materials, or finished products. The wasteful use of real assets in the past has been due in part to the fact that capital furnished from state funds was free to the enterprise and that penalties for holding excess stocks of materials and products were small. The regime hopes, moreover, that the inclusion of the capital use charge in prices, the next time these are revised, will permit more accurate calculations of the productivity of investments.

2. Problems

Introduction of the capital use charge has given rise to various problems and complaints. The chief problem is the valuing of assets on which the charge is to be levied. Because the charge is in the nature of a rental fee for real capital entrusted to the enterprises by the state, the ideal valuation of assets would represent their replacement cost less an allowance for obsolescence and for any reduction in their physical effectiveness. In Hungary, however, neither the gross values nor the depreciated values of assets even approach this standard. The situation is worse in Hungary than in the other more industrialized countries of the Bloc because Hungary has had no inventory and detailed revaluation of assets since 1949, whereas the USSR, Poland, and Czechoslovakia already have conducted such inventories and East Germany is in the process of completing one. For the time being, gross values are being used in Hungary because the depreciation now being carried on enterprise accounts has little economic significance. The inequities that necessarily would result from the inadequate valuation of assets have been recognized, and the charge will be applied in a flexible manner. The Ministry of Finance and the National Price Office are granted authority to exempt certain types of capital and even entire enterprises from payment of the charge, and the planning organs have been instructed to take into account the profit-reducing effect of the charge when preparing profitability plans for enterprises. With flexible application the regime hopes to create an incentive effect without unduly penalizing firms for circumstances beyond their control.

The regime also may have to conduct an educational campaign before it can achieve the hoped-for results from the new measure. Because the new concept is so alien to previous economic thinking in the Bloc, it is widely misunderstood and has created much apprehension. Fears have been expressed, for example, that the charge may discourage the introduction of new technology, encourage overproduction of some goods, and reduce workers' shares of profits. None of these situations should develop unless the program is very ineptly executed, but if workers and managers expect them and consequently fail to cooperate, results may be disappointing to the regime.

3. Evaluation

The importance of the capital use charge lies more in its novelty than in its direct effect on the Hungarian economy. Enterprise managers will still operate among a wide variety of directives, incentives,

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and constraints, many of which are likely to carry more weight that the capital use charge. In many instances, managers may be willing to pay the rather modest capital use charge on surplus stocks and equipment in order to be protected against irregularities in the distribution system, especially if fulfillment of plans for production or export or other criteria continue to be at least as important as profits in determining eligibility for bonuses. More intensive use of capital usually requires increased supplies of materials and manpower, but these are rationed or controlled by the government and few surpluses are available. Moreover, managers have little leeway for modifying planned production schedules to make the best possible use of capital. Nevertheless, there may be some improvement in the utilization of fixed capital and possibly a reduction in the output of unwanted products within the planned production groups.

Even after the charge has been reflected in prices, its effect on incentives will be restricted by the rigidities of planning. As long as manpower and materials are allocated and production is planned in detail, the freedom of managers to act will remain limited, and the effectiveness of the capital use charge as an incentive to operating efficiency will not be much greater than at present. Adjusted prices, however, will help planners to form better judgments of the relative merits of alternative programs for investments, production, or trade. To the extent that managers are permitted to participate in drafting plans for production and investment, some improvement in economic efficiency may result.

Even though the capital use charge alone cannot be expected to produce major improvements in the Hungarian economy, it may be the forerunner of more far-reaching economic changes. Willingness on the part of the government to introduce this measure implies a much more flexible interpretation of Marxist ideology than formerly. It is unlikely that state controls over the economy will be greatly curtailed, but some further decentralization of decision-making to enterprises is probable. If this happens, and managers consequently are allowed reasonable freedom of action in hiring, procuring material, and deciding on the amount and types of products to be made, the capital use charge may prove to be an effective stimulus to more efficient use of assets and greater productivity.

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Analyst: [redacted]

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6 April 1964

MEMORANDUM FOR: Chief, Dissemination Control Branch, DD/CR

FROM : Chief, Publications Staff, ORR

SUBJECT : Transmittal of Material

It is requested that the attached copies of CIA/RR CB 64-23, The Capital Use Charge in Hungary, March 1964, Confidential, be forwarded as follows:

State, INR Communications Center,
Room 7818, State Dept. Bldg.
For Embassies in Budapest & London

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[redacted]

Attachments:
Copies #192 & #193 of CB 64-23

ACTION COMPLETED
The dissemination requested by this memorandum has been completed.
BY: MDB
Date: 7 April 64

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